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Business and Economic Conditions

New York, July, 1957

General Business Conditions

THE business reports continue to show a good deal of spottiness, although in the aggregate they add up to high activity. Any summary of the situation at midyear would stress such elements as sustained business investment plans, continued heavy outlays by federal, state and local governments, and record-breaking employment and money incomes which are translated into sustained consumer buying. In over-all terms the economy is fully employed. By all signs the total output of goods and services in the quarter just ended has shown a further mild gain, certainly as measured in dollars and perhaps in real terms also.

On the other hand, some sections of industry find it necessary to adjust to changing inventory policies and to a moderately reduced flow of new orders. In May the Federal Reserve index of industrial production (1947-49 = 100) eased another point to 143, which is four points below the December 1956 record. The June figure is expected to be about the same. With plant-wide vacations now the rule, and the summer lull more pronounced than it was some years ago, July and August are not likely to bring improvement.

The five months' dip in industrial production parallels last year's experience. In both years also, the early months have brought increased caution in purchasing. New orders received by manufacturers declined irregularly during the first four months of each year. But whereas in 1956 new orders, though declining, exceeded shipments and order backlogs were on the rise, this year factory shipments have exceeded new orders by $2.4 billion. Nevertheless, the backlog, at $60.8 billion on April 30, was over $2.8 billion greater than a year earlier. By historical standards, unfilled orders are high and in many lines a basis for continued confidence.

Inventory Changes

This contrast between a sluggish production index and stable or rising final consumption has been the principal feature of the first half-year's business news. In late 1956, the economy produced more than it consumed, and added to stocks. This year, business has been dipping into stocks and the economy is consuming more than it is producing. Prospects for the second half hinge on whether sustained final demand will bring production back up to current consumption levels or whether lagging output will set off a downturn in demand generally.

So far the gap between output and consumption has been a narrow one, amounting in the first quarter of 1957 to only about $1 billion out of a gross national product of $427 billion (seasonally adjusted annual rate). This implies the now familiar pattern of offsetting individual adjustments rather than general liquidation. Doubtless the chief influence has been a turn from scarcity to more abundant supplies of various materials that were tight in 1956, and a gradual shortening of delivery dates as production has

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been increased. Even where higher prices may be in prospect, buyers are cautious.

The inventory adjustment so far has been so mild that it has not shown up in the figures on book values. With the talk of changing inventory policy, many observers have been puzzled to see the Department of Commerce data on book value of stocks continue to advance steadily at the rate of about $2 billion a year. As nearly as can be judged, this rate of increase, which is much slower than prevailed in the latter part of 1956, represents higher prices. The physical volume of stocks is estimated to have dropped at an annual rate of $1.2 billion during the first quarter.

Pressure on Prices

It is typical of the cross-currents in the economy that, at a time when shortages are disappearing, orders declining, and inventories being worked off, the upward trend in prices is still strong enough to keep the book value of stocks rising. Even in markets of doubtful strength, higher costs are exerting their pressure. Despite reduced sales and sizable stocks, firms manufacturing television sets, laundry equipment, and certain types of textiles increased prices during June. Several leading oil companies, feeling the pressure of a recent 6 per cent increase in wage costs, advanced prices for gasoline, kerosene, and fuel oil, although stocks of petroleum products are heavy and crude oil production is scheduled to be cut further in July.

Steel mill operating rates have dropped about 13 per cent during the first half year. Few expect a revival in steel demand in the coming weeks. Yet on July 1 the steel industry's union contract brought into effect a wage increase of 4 cents an hour under the cost of living escalator clause and annual contractual increases in wages and fringe benefits equivalent to 12½ cents an hour according to union estimates and 17 cents according to management. The industry has raised prices $6 a ton as an offset to these increased costs. This in turn will add to costs in other industries and give another whirl to the merry-go-round of wage-cost-price increases.

Capital Expenditures Still Rising

The desire to offset the pressure of higher labor costs continues to be one of the prime reasons behind the record-breaking outlays for new plant and equipment. The latest report of the Securities and Exchange Commission shows that business is still expecting to increase capital expenditures in the months ahead. In the first quarter, over-all capital spending equaled the amount business men had been planning to spend when surveyed in January and February. Outlays in the second quarter are estimated at a seasonally adjusted annual rate of $37.3 billion, up $440 million from the first quarter. A further rise of $560 million is scheduled for the third quarter. Altogether, such expenditures in the first nine months of 1957 are expected to be 9 per cent greater than those in the 1956 period.

These gains cannot compare with the 22 per cent increase registered in 1956 over 1955. No one expected that such a rate of expansion could last. The current, more gradual rise indicates that capital expenditures are approximately at a peak – a peak set both by business plans and by the ability of the economy to produce and finance the desired volume of capital goods.

The repeated affirmations of a continued rise in capital expenditures during 1957 are not necessarily at odds with scattered reports of reduction in programs. An example of the effect of rising prices on plant and equipment expenditures is the experience of West Virginia Pulp & Paper Company, whose president, David L. Luke, Jr., recently stated that the company was continuing with its $100-million capital spending program launched in 1955. "But," he explained, "the program will be somewhat more limited than we originally conceived. Actually, due to higher costs, it would cost $130 million to achieve that original program." As in other sectors of the economy, the capital goods dollar does not stretch as far today as it did in 1955.

Cross-Currents and the Outlook

This brief summary indicates that although business holds at a high level, current trends are mixed and not wholly consistent. The strength of the capital goods boom and of the demand for money have been pointed up not only by the increase in bank loans this spring but by the record offerings and price weakness in the bond market. The half year total public offerings of bonds exceeded $9 billion, against $6½ billion a year ago, according to the *New York Times*. This money is raised predominantly to pay for business plant and equipment, for schools, roads and other governmental purposes. It is currently the major support of business activity. Nevertheless, new orders received and unfilled orders held by durable goods manufacturers have declined. The question that arises is whether these developments mark a climax to the capital goods boom, or whether the slackening in orders represents only a temporary lull.

Other inconsistent trends appear in various wage and price relationships. The cost of living is rising but industrial raw materials on the aver-

age — steel being an exception — have eased further; important examples are copper, lead, and zinc. The official wholesale price index for manufactured goods has been in a sideways trend for a good many weeks. Wage rates are going up and will go up more, but overtime work is lessening and average take-home pay of factory workers has been declining while higher living costs have cut into real purchasing power.

The question raised by these changing relationships is whether the higher costs resulting from the wage increases can be passed on; whether the end-result of these inflationary pressures is to be the continuing rise in the price level which so many expect, or whether higher wages and costs will only diminish the market for the higher-priced labor and goods. No industry sells only to its own employees, and all the industries together do not sell only to their own employees. The maintenance of full employment depends upon the maintenance of the real buying power of all segments of the population; and continuous steady advances in the cost of living such as have occurred in the past fifteen months reduce the purchasing power of every segment which does not have an equivalent increase in income. This includes everyone living on a fixed or relatively fixed income, such as pensioners.

The evil of inflation lies not only in the long-run erosion of purchasing power through money depreciation, but in the shorter-run boom-and-bust effects. It is disheartening to think that if wage increases scheduled for this year should price labor and goods out of the market and bring on recession, the effect will probably be attributed in many places to tight money and the blame wrongfully placed on the monetary authorities. The country should understand where the danger lies.

The summer months, with their normal seasonal dullness, are unlikely to bring much clarification of these uncertainties. Meanwhile good grounds for hope of a fourth quarter upturn exist. Continuation of inventory adjustment through the summer will improve the fall outlook. Recent increases in housing starts and a slightly better supply of mortgage money indicate that the bottom of the slump in residential construction may have been passed. A fourth quarter upsurge in automobile output following the introduction of new models, with corresponding purchases of steel and other materials, is to be expected. Activity in trade, finance, government, and other growing service industries will support employment and provide an element of stability and a possible rallying point.

Creeping Inflation

The 3.6 per cent advance of living costs over the past year — after a three year interlude of stability — has rekindled the nation's concern over price inflation. A main achievement of President Eisenhower's first term of office — the stabilization of the dollar — is being eroded. More people are predicting with greater assurance that broad averages of prices will keep on rising, chronically if not continuously, into the indefinite future.

Donald B. Woodward, chairman of the finance committee of Vick Chemical Company, in a speech before the Controllers Institute of America in New York, last October 1, stated flatly: "We shall experience a rising price level for the rest of our lives; the rise may be irregular, but it will be unmistakable." A leading investment advisory service reported not long ago that it is "convinced that we are in a long-term cycle of inflation, which will be interrupted for comparatively short periods with interludes of stability and then resume its downward march in falling purchasing power of the dollar."

Indications of renewed concern about inflation are evident on all sides. Congressional committees probe into the forces pushing up the cost of living. President Eisenhower, in his news conference June 26, called on business and labor to exercise "statesmanship" in their price and wage policies to avoid the "real danger of inflation."

That people have become more inflation conscious is shown in the growing popularity of provisions for cost of living escalator clauses and for reopening of wage negotiations in long-term labor contracts. At the beginning of this year some four million workers had their wages related to the Bureau of Labor Statistics' consumer price index — about double the number of two years ago. Further indications of popular doubt about the future value of the dollar can be seen in the proposal not long ago that New York State gear its insurance programs for unemployed, sick, and injured workers to changes in the cost of living. In the money market higher interest rates reflect among other things the demand of savers for better rates and the expectation that the dollar repaid tomorrow will be worth less than the dollar lent today.

Cost-Push Inflation

Many leading businessmen and economists attribute the steady rise in prices to wage advances greater than warranted by increased worker productivity. These advances have increased unit costs which, in turn, push prices higher. Robert C. Tyson, chairman of the finance committee

of United States Steel Corporation, described this process before the National Industrial Conference Board on May 16: "Our new kind of inflation appears to be cost inflation pushing prices up, rather than price inflation pulling up costs through competitive bidding for materials and manpower. We might think of it as a new 'cost-push' type as distinguished from the conventional 'demand-pull' type of inflation."

Small business, having little option but to accept labor contracts comparable to those negotiated by industry leaders, often is inclined to blame big business for being too generous in labor contract settlements. But even big business is no match for the power of industry-wide unions which, exempt from antitrust laws, can knock out of business any one of the major industrial competitors. The process of wage contract negotiations at the big business level was aptly pointed up by Mr. Tyson in his speech before the Conference Board. He noted that a union leader measures his success by his ability to outdo what other union leaders achieve and added:

> . . . In this framework it is most difficult for any one leader to refrain from engaging in this game of leap-frog up the ladder of wage inflation.
>
> It is likewise difficult for individual managements to resist wage demands successfully since long strikes can lead to business suicide. The record is clear, moreover, that industry resistance, long continued, always brings government intervention and an unvarying public verdict that it is better for wage costs to go up than for production to stay down.

Mr. Tyson might have gone on to point out that most leaders of organized labor, while critical of advancing prices, are constant advocates of cheap credit and bigger government spending which create the market conditions in which industry can advance prices and finance higher labor costs.

A 2 to 3 Per Cent Creep

The creeping inflation that we have been experiencing represents the fulfillment of predictions which Professor Sumner H. Slichter of Harvard has been making for more than 10 years. He still sees more of the same: a 2-to-3 per cent annual increase in prices over the next decade.

Professor Slichter, who first achieved prominence in the field of labor economics, places a considerable emphasis in his analysis on the strength of organized labor. Following are the principal factors in his thinking as reflected in letters to the editor printed in the *New York Journal of Commerce* February 11 and 27:

1. Labor unions will make full use of the bargaining powers that full employment confers on them to push up wages faster than the gains in labor productivity.

2. A policy of deliberately creating unemployment to hold down wages is not feasible. The large labor unions would demand that everyone connected with the policy of creating unemployment be removed from office. Labor would drive hard for the election of an easy money Congress, and, helped by the anger of the public toward deliberately created unemployment, there is little doubt that labor would be successful.

3. Creeping inflation will not ultimately speed up and precipitate a "bust." There are three restraining influences — (1) the role of competition in keeping price advances close to rises in costs; (2) the role of technological progress, and the risks involved in it, in holding back anticipatory equipment and materials purchases; and (3) the role of monetary policy in blocking the creation of debt for purposes of taking advantage of anticipated declines in the purchasing power of the dollar.

Professor Slichter advocates creeping inflation as an alternative to unemployment or direct controls of wages and prices. In a speech before the New York Society of Security Analysts on November 8, 1956, he stated:

> It would, of course, be nice if prices would not rise, but the dire predictions that one reads every now and then about the consequences of a slow inflation strike me as ridiculous, particularly when the inflation is initiated by a rise in labor costs to which commodity prices more or less sluggishly adjust themselves. In this imperfect world we are often compelled to choose between evils, and if the choice is between enough unemployment to halt the rise in labor costs, direct controls of wages and prices, and creeping inflation, let us by all means have the creeping inflation. It is the least of the three evils.

A Perilous Course

There are, of course, many who would challenge Professor Slichter's characterization of the consequences of slow inflation as "ridiculous." C. Canby Balderston, Vice Chairman of the Federal Reserve Board of Governors, in a speech before the Health Insurance Association of America May 8, pointed up the danger of a complacent attitude towards inflation:

> A misconception that is part of our intellectual currency today is that a little inflation is a good thing. A little inflation, sometimes thought of as roughly 2 per cent a year, would double the price level every 35 years. However, even if we accept the inevitability of creeping inflation, and I certainly do not, it is not possible to have just a "little" inflation.
>
> Once a community accepts the prospect of continued inflation and begins to make its business decisions in the light of that prospect, the infant ceases to creep. It learns to walk, run, and finally gallop even though the gallop may carry it over the brink of the precipice that everyone agrees must be avoided. . . .

Mr. Balderston speaks for those who distrust the efficacy of Professor Slichter's restraining influences once the business community and the public become aware that it is deliberate government policy to progressively depreciate the purchasing power of money. As Dr. Heinz Luedicke, editor of the *New York Journal of Commerce*, put it in the course of a debate with Professor Slichter in that newspaper:

> Once the public catches on – in other words, once the fact of inflation stops being a secret among a relatively small group of insiders who know the ropes – the chances for making inflation profits disappear rapidly as the inflation process is accelerated. Once that point is reached, anticipatory buying comes into the picture and the demand-price spiral gains momentum. Unless stopped, such a process feeds upon itself and can end up only in currency deterioration.

That Professor Slichter recognizes this danger is evident from his citation of the role of monetary policy in restricting credit to people who are buying ahead of needs and seeking inflation protection. The question that will occur to many, however, is whether he is not underestimating the magnitude of the task he is assigning to the monetary authorities. Formidable as are the difficulties of such controls in ordinary boom times, they may well become insuperable if and when the idea percolates through the community that the Government has definitely embraced long-term inflation as a policy.

In short, the trouble with chronic inflation is that it denies the economy a stable unit of account and store of value. It distorts saving habits, turning the normal supply of savings out of established channels where they become available to buy bonds and mortgages and into channels of speculation in real estate and equities of all kinds. It raises interest rates and upsets the balance of the money market. It adds to the burden of taxation because taxes fall on fictitious profits that really measure only the depreciation of money. It destroys the basis for the orderly forward planning necessary for sound and balanced development.

All this is apart from the question of the morality of a policy that robs beneficiaries of life insurance policies, pensioners, and others dependent upon fixed income from savings who, because of lack of sophistication in such matters or for other reasons, are unable to take to the inflation cyclone cellars.

Moreover, the U.S. dollar has been an anchor of stability for friendly nations which hold their currency reserves in dollars. A policy which acquiesces in creeping inflation invites at some point a run from the dollar with all the evil consequences involved in such a crisis of international confidence.

Over-employment

In the past, business declines brought about downward adjustments in wages and prices – or at least retarded increases – as the boom ran its course and stability was restored. The new element in the picture since the end of World War II is the contribution of heavy government spending toward perpetuating the boom. To achieve "full employment," conditions of labor shortage are maintained – at the expense of a dwindling dollar.

Definitions of "full employment" vary; there are differences of opinion over the "tolerable" level of unemployment. Neil H. Jacoby, former member of the President's Council of Economic Advisers, states in the May-June issue of the *Harvard Business Review* that "frictional" unemployment, involving an everchanging group, is a desirable feature of a free economy: it encourages people to seize better opportunities. Dr. Jacoby, now Dean of the Business School at the University of California at Los Angeles, feels that the economy has full employment in a practical sense when 96 per cent of the work force has jobs and 4 per cent are in the process of changing jobs – though he notes that many believe the ratios are closer to 95-5 per cent.

Senator Paul Douglas, in his 1952 book, *Economy in National Government*, suggested that a normal proportion of seasonal and transitional unemployment would run near 6 per cent. Wrote Mr. Douglas, an economist who has made a life-long study of employment statistics: ". . . For in a period when unemployment is less than 6 per cent, there is no real supply of workers ready to go into productive activity. Instead, the unemployed are primarily either the hard core of the perennially unemployed, such as the handicapped, and the transitionally unemployed for whom job openings exist . . ."

Over the past 10 years unemployment in this country has averaged less than 4 per cent of the civilian work force. Moreover, despite drawing into the labor force hundreds of thousands more teenagers, married women, and older workers than would normally be expected, there have been during the past year or two widespread shortages of labor – especially skilled workers.

When employers have difficulty finding the help they need they bid up wages and pass on increased costs in higher prices. With order books full, employers are likely to be generous in meeting union leaders' demands in order to avoid costly strike shutdowns. Thus, over-em-

ployment builds up payroll costs and consumer demands beyond the productive capacity of the economy and price inflation results.

Dr. Jacoby, in his recent book, *Can Prosperity Be Sustained?*, effectively answered those who advocate full employment policies regardless of the inflation to which they give rise:

> Price inflation during the past decade has pauperized millions of elderly and disabled Americans living on fixed dollar pensions and annuities. It has painfully squeezed the living standards of school teachers, government clerks, and others on low and inflexible salaries. Since 1941 more human suffering has been visited upon Americans by the doubling of consumer prices than by unemployment. In the face of this record, who will say we need not be as much concerned about a dollar of stable value as about full employment?

Full Employment and Central Bank Policy

Undeniably, the widespread acceptance by governments of this full employment philosophy poses a dilemma for central banks concerned also with preserving the value of money. But the idea that the the central bank is powerless in this situation is inadmissible. To argue, as does Professor Slichter, that the alternative to creeping inflation is "a policy of deliberately creating unemployment to hold down wages" is to distort the issue. Certainly no central bank would set out to "deliberately" create unemployment.

On the other hand, it is the duty of the central bank to exercise its best efforts towards ironing out the peaks and valleys of economic fluctuation. A central bank would be derelict in its obligations if it did not, when business is booming and people are attempting to undertake more projects than there is labor supply to handle, act to moderate the excess pressures and bring demand for labor into a sustainable relationship to supply. The issue is not one of deliberately creating unemployment but of easing the stresses and strains of over-employment that promote and nurture the wage-price spiral.

True, any application of restraint involves a risk of swinging the balance the other way. However, no one need suppose that continued tolerance of inflation affords any promise of permanent immunity to deflation and unemployment. Experience has repeatedly shown that the longer inflation is allowed to run on, the more painful the aftermath is likely to be.

The "Scarcity" of Money

From every side one hears complaints of the scarcity of money to borrow and the increased rates of interest that must be paid to obtain funds. Institutional lenders — banks, insurance companies, savings associations and pension funds — do not have enough resources to satisfy the demands of all applicants. The volume of home-building has had to be cut back for lack of a bigger supply of mortgage credit. Industry and State and local governments are having troubles borrowing to finance increased capital outlays. Even the U.S. Government is not exempt from embarrassments.

Holders of U.S. securities, attracted by more advantageous uses for funds, are redeeming them in such volume as to keep the Treasury cash position under continuous strain. To meet its obligations the Treasury has been using the emergency device of increased issues of discount bills which are sold on an auction basis. In order to tempt people with idle cash balances to part with their money temporarily to earn a rate of interest on discount bills, the Treasury during June accepted bids as low as $991.36 for bills that will be redeemed for $1000 in September. This was equivalent to an interest cost of 3.418 per cent per annum — a full 3 per cent above the pegged level of ⅜ per cent maintained during World War II and the highest rate paid by the Treasury since the banking holiday in 1933.

However, the most striking change in the last few weeks has been the increase in the cost of money to business corporations raising record sums to finance plant expansion and improvement programs. Some corporations of substantial creditworthiness paid 5 to 6 per cent during June to float new bond issues.

The Byrd Inquiry

In this situation the Senate Finance Committee on June 18, under the chairmanship of Senator Harry F. Byrd of Virginia, opened hearings on an investigation of "the financial condition of the United States" with Secretary of the Treasury Humphrey as the first witness. The investigation, authorized by a unanimous vote of the committee on April 12, will look into questions of price inflation, interest rates, the public debt and its management, and the factors that influence the availability of credit.

The immediate occasion for this "full dress" study, Senator Byrd stated, "is the existing credit and interest situation and, more important, inflation which has started again with its ominous threat to fiscal solvency, sound money and individual welfare."

During the course of the investigation it is almost certain that major attention will be devoted to questions as to why interest rates should be so high and why there should be such a shortage of money to borrow. As Congressman Wright Patman of Texas so often has demanded, should not the Federal Reserve Banks be asked or re-

quired to make loan funds more easily available at lower rates?

As a cue to some of the thinking in the Senate on the question, Democratic Leader Lyndon B. Johnson of Texas told the Senate that the Eisenhower Administration's "tight money" policy can lead only to depression and is "the most self-defeating policy that any Administration has ever adopted in this nation." "Hard money," he said, is an "economic cancer which clogs the normal arteries of trade and commerce and chokes our normal growth and development."

The subjects to be studied by the Byrd committee have been explored several times since World War II by subcommittees of the Congressional Joint Economic Committee. The best known is the Douglas inquiry of 1949-50 which led to the freeing of the Federal Reserve from Treasury domination and reached the much-quoted conclusion:

> As a long-run matter, we favor interest rates as low as they can be without inducing inflation, for low interest rates stimulate capital investment.
>
> But we believe that the advantages of avoiding inflation are so great and that a restrictive monetary policy can contribute so much to this end that the freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be restored even if the cost should prove to be a significant increase in service charges on the Federal debt and a greater inconvenience to the Treasury in its sale of securities for new financing and refunding purposes.

Nevertheless, as Senator Johnson's charge suggests, there still exists much misunderstanding of the relations between interest rates and inflation, and how really "hair-curling" crises are generated out of excessive debt expansion. Republican senators asserted that the investigation was "politically motivated," on the idea that the Democrats would try to make hay out of the unpopularity of higher interest rates and the popularity of inflation.

As a matter of record, it is hard to find in American political history instances where candidates won on outright inflationist platforms. Bryan tried and lost. Roosevelt might have won on such a platform in the depths of the 1932 depression but chose instead to promise retrenchment in public expenditure.

Further confusing the picture is the staunch conservatism of the Democratic chairman of the Finance Committee, not to mention the fact that the withdrawal of Federal Reserve supports to government security prices was championed by a Democrat, Senator Douglas of Illinois, and accomplished during the Truman Administration.

It is to be hoped that the investigation will be conducted impartially and with a view to developing policies which can restore a better balance in the money and capital markets and a sound and honest dollar as a basis for economic progress and social security. The Congress and Administration can have lower interest rates if they will adopt appropriate fiscal policies.

No Simple Answer

One often hears expressed the idea that the high interest rates and shortage of loan funds are the result of some sort of "conspiracy" among lenders. The answer, however, is not so simple as that. There are too many lending institutions — beyond 40,000 — competing with one another in the United States. If there were any conspiracy it would be one in which tens of millions of savings depositors also share, for they are getting higher rates on their savings than have been paid in more than twenty years. The biggest single recipient of interest is the Government's own old-age insurance trust fund which this year will collect more than $500 million interest from the U.S. Treasury.

Moreover, if there were any conspiracy it would have to be an international cartel including the ministers of all socialist governments. For advancing interest rates and shortages of loan funds are a universal, world-wide phenomenon. By way of illustration, the following table represents an assembly of the cheapest rates at which business firms of the highest credit standing can borrow on an unsecured basis in 54 countries. It must be borne in mind that money is scarce at these minimum rates; that most borrowers able to obtain funds pay higher rates; and that, in many countries abroad, borrowers have to pay, besides interest, loan commissions and/or other extra charges.

Current Prime Loan Rates in Various Countries

Country	Rate	Country	Rate
Bolivia	16*	Iraq	6-7
Korea	12-15	Singapore	6-7
Chile	12-14	Spain	6-6½
Greece	12	Colombia	6
Brazil	12	Dominican Rep.	6
Israel	11	El Salvador	6
Peru	11	Guatemala	6
Ecuador	10	Liberia	6
Austria	9½	South Africa	6
Mexico	9½	Venezuela	6
Germany	9	India	5½-6½
Japan	9	Egypt	5½-6
Finland	8-8½	Hong Kong	5½-6
Argentina	8	Australia	5½†
Uruguay	8	Canada	5½
Iran	7½-8½	Netherlands	5½
Italy	7½	Great Britain	5¼-5½
Turkey	7-9	Philippines	5-7
Denmark	7-8	Belgium	5-5½
Syria	7-8	Portugal	5-5½
Costa Rica	7	Cuba	5
France	7	New Zealand	5†
Honduras	7	Panama	5
Lebanon	7	Norway	4¾
Nicaragua	7	Switzerland	4½
Sweden	6½-7	Puerto Rico	4¼
Ireland	6¼	United States	4

* Not including 9 per cent representing tax and other charges.
† Trading banks average rate.

Compared to business borrowing costs abroad, or to what foreign governments themselves are required to pay to borrow money, interest rates in the U.S. still stand about the lowest in the world. Incidentally, it is the relative lowness of rates here that leads many foreign borrowers to seek funds in the New York market, thus adding to the pressures of credit demands under which our lending institutions are laboring.

Rising interest rates world-wide are a reaction to the long era of cheap money and expectations that money will keep on wasting away in the process of creeping inflation. The price of borrowed money — the interest rate — is a matter of supply and demand. Higher rates are needed to bolster the inducement to save because savers are tired of being victimized by inflationary fiscal policies. Savers are important people: if they give up hope for sound, trustworthy money they can rush into equities, denude the market of loan funds and turn creeping inflation into the galloping variety that knows no bounds. Neither banks nor the economy can do without them.

Rates are higher because people seek to borrow more. People need to borrow more because taxes take so much of their income and prices are higher. Also they want to borrow more because they anticipate rising incomes and rising price levels. They want to borrow 1957 dollars, pounds or pesos and pay back in corroded future dollars, pounds or pesos.

The paradox of inflation is that, when people are alert to price consequences, the more money that is created the harder it becomes to borrow. Spokesmen for inflation become unwitting advocates of still higher interest rates.

Discouragements to Savings

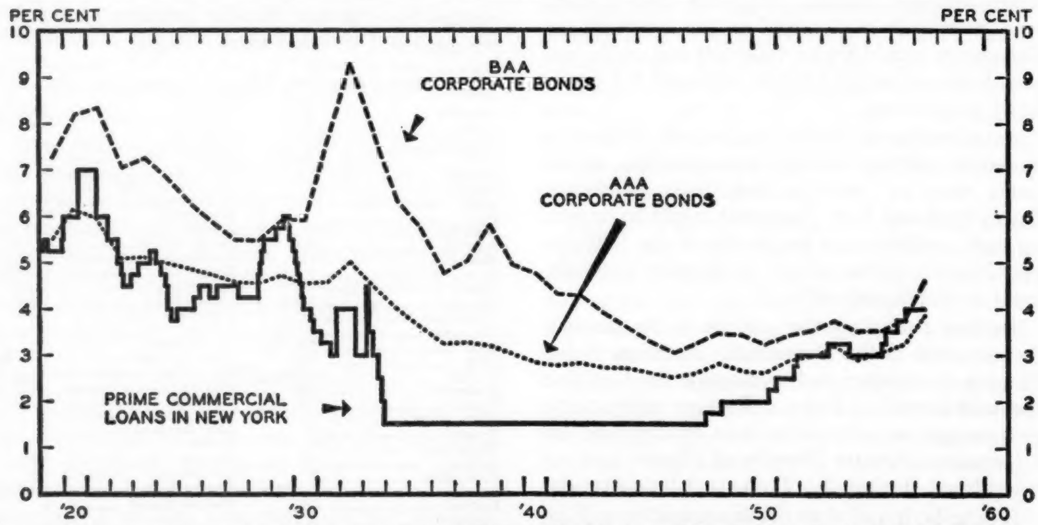
Looking back over the record, interest rates in the United States today are high only by the standards of the artificial cheap money era of 1933-51. This is brought out by the chart at the bottom of the page presenting yields on corporate bonds and the prime commercial loan rate in New York City since 1919.

The really amazing thing is that interest rates remain as low as they are. There are at least three brand new elements that have been introduced into the economy over the past 25 years that reasonably would dictate higher rates than those experienced in the past. One of these is creeping inflation which intensifies credit demands and discourages savings.

Secretary Humphrey referred to this in his testimony before the Byrd Committee. Asked by Senator Byrd to explain the weakness of demand for long-term bonds, he replied:

> I think the fear of inflation is very definitely in the minds of a great many investors, and I don't know why it should not be.

A second factor is the emphasis on social security protections which supplant individual needs to save. Almost everyone today will qualify for one or more types of retirement pay, from public or private sources. There is the unemployment insurance system. There are federal programs designed to aid farmers, war veterans, and so on.



Prime Commercial Loan Rate in New York City and Yields on Moody's Aaa and Baa Corporate Bonds, Annual Averages
(1957 figures are as of June)

In the third place there is the element of extortionate tax rates. Estate and inheritance taxation since 1934 has been appropriating for public expenditure major slices of the capital funds accumulated by successful people. There is income taxation. Except for interest on state and local government obligations, which is free of federal income tax, high interest rates are more apparent than real. Income tax takes away anywhere from one fifth to nine tenths of the interest. To an individual in the initial income tax bracket a 5 per cent rate is really a 4 per cent rate; to a sizable bank or business corporation it is a 2½ per cent rate; to an individual in higher income brackets it is not even worth calculating.

The blunt fact of the matter is that when account is taken not only of the taxation of interest income but also of the erosion of the dollar, many bond holders for many years have been getting no return at all. In such circumstances how is it possible to speak of interest rates as being too high?

No Absolute Shortage

Difficult as it may be for many rejected borrowers to believe, there is no absolute shortage of money or credit in the U.S. People owe more money on their homes than ever before and the total is still rising, albeit at a somewhat slower pace than in 1955 and 1956. People have more instalment indebtedness than ever before and the total reported each month reaches a higher figure than in the corresponding month a year ago. Business corporations for the third consecutive year are incurring indebtedness at rates never before experienced. States and their political subdivisions are constantly borrowing money and raising their aggregate indebtedness to new record peaks with each passing month. The indebtedness of the Federal Government has been stabilized close to the $275 billion public debt limit; nevertheless, the grand total of indebtedness of all sorts has been rising at an average rate of more than $30 billion a year and is now approaching $700 billion.

Correspondingly it may be noted that, with due allowance for normal swings over the seasons of the year, the actual supply of money in the country has been repeatedly touching new records. The increase is being held to modest proportions but people have been speeding the velocity of the existing money supply and making it go farther. Increased issues of discount bills by the Treasury, and similar money equivalents by others, have been attracting into circulation money balances normally held idle, expanding the liquid assets of the economy, helping to finance the largest volume of money transactions ever experienced, and keeping the inflationary fires burning.

As Secretary Humphrey brought out in his testimony, shortage of money and credit is relative rather than absolute; demands for money and credit have been outrunning the supplies. Since the labor force is fully employed, we can use more money and credit only by bidding away labor and materials from someone else – driving wages and prices still higher. And the higher wages and prices go the more credit is wanted. Thus we have the bear by the tail.

The way to hold back the pressure of excessive wage advances on prices is to relieve the labor shortage created by attempting too many projects at one time. This can be done by making money harder to borrow and by curtailing public expenditures.

The Byrd Committee, through its current inquiry, will have difficulty improving on the conclusions reached, after careful study, by the five-man subcommittee of the Joint Economic Committee headed by Representative Wilbur Mills. In a unanimous report on June 26 it concluded:

> The rapid expansion of Federal Government spending in recent years, coming on top of sharp increases in consumption and investment in the private sectors of the economy, has contributed significantly to current inflationary pressures. . . .
>
> . . . public policies to cope with increases in the price level must take the form of general fiscal and monetary restraints on the expansion of total spending.

Restraints in the Free Society

No one can properly question our rights to spend, lend, or invest our own money. In the free society these decisions are outside public control, except perhaps through tax decisions which decide how little of what we earn may be retained as "disposable income". But some people seem to feel that we should have corresponding rights to borrow as much as we please. This is inconsistent with stable money. If we could have all the money we want we wouldn't want any. No one would be willing to put in work effort, or part with valuable goods, to obtain what is free for the asking. Money must have a scarcity value or it is no good at all.

We must have an authoritative body to control money and credit. The body charged with this responsibility in the U.S. is the Federal Reserve System which regulates the supply of cash on which the whole credit superstructure is erected. From the record of the figures already cited on money supply and growth of indebtedness, it is apparent that the Federal Reserve authorities

are not reducing the supplies of money and credit. They are applying brakes on the growth and letting pressures of excess demand be felt.

The fact that consumer prices are rising would indicate that the Federal Reserve authorities have been too indulgent, rather than the reverse, in supplying credit. On the other hand, the complaints of difficulties in borrowing indicate that Federal Reserve policy is effective in limiting the rise of expenditures and prices.

Public Expenditures

There is a tendency to expect restrictive Federal Reserve credit policies to do the whole job of protecting the dollar from further depreciation. Credit restraints, like high taxes, suffer the fault of constricting mainly the sphere of private enterprise and the spending of the individual for his own enjoyment. If government expenditures rise out of hand, it can be quite impossible – whatever inconveniences are imposed on private and personal access to credit – to hold inflationary forces in check.

One of the healthiest things that can come out of the Byrd inquiry is a recognition of the part that public finance is playing in the inflationary spiral. If the Federal Government wants stable money and lower interest rates, it can have them by reducing its expenditures, its demands upon the money market, and its tax claims upon the citizens' income. As Senator Byrd pointed out, Government cannot take so much of the national income without putting upward pressures on prices. As Secretary Humphrey has pointed out, neither can private industry go ahead indefinitely without reliefs from present, war-emergency tax burdens.

It is impractical to let pressures on the money market develop to a point where the Treasury cannot finance its billions of monthly outlays and monthly maturities. Thus federal finances are the weak point in the defenses against inflation. It is for decisions on federal spending to determine the future value of the dollar.

A stable dollar can be reachieved by essentially the same fiscal methods that were employed in 1953-54 – namely, reducing federal expenditures and taxes. If tax reduction could embrace a reduction in corporate as well as individual income tax rates within an overbalanced budget we could bring some relief to the pressure of corporate needs for funds in the money market. At the same time business would be given some ability to absorb cost increase without price increase. With further help from a limitation of Federal Government demands upon the markets, the cost of living could be stabilized and the escalator part of pay increases eliminated. Individual income tax reductions could add to disposable income, supplant government procurement, and brighten the outlook for every enterprise seeking to satisfy the desires of people to improve their living standards and meet the personal budget pressures of growing families. The citizen could save with greater confidence. The vicious circle of creeping inflation could be broken.

There is this way out if only we can have the wisdom and courage to see it.

Classroom "Contributions"

The debate over the Administration's controversial program for aid to the States for school construction waxed as hot as the weather in June.

President Eisenhower, at the Annual Conference of State Governors, held in Williamsburg, Virginia, took the occasion to renew his pleas for "temporary" federal programs to meet a "critical" shortage of classrooms:

> Opposed though I am to needless Federal expansion, since 1953 I have found it necessary to urge Federal action in some areas traditionally reserved to the states. In each instance state inaction, or inadequate action, coupled with undeniable national need, has forced emergency Federal intervention.

The President encountered sharp dissent among the Governors, who had on their agenda discussions of school problems and ways of getting more effective use out of existing classroom space. Governor William G. Stratton of Illinois, for example, stated flatly that the federal school aid program "was unnecessary and would lead to federal control of education."

It is indeed hard to see how the traditional decentralization of government in America will have any chance for survival once the school systems begin to teach children the virtues of federal financial support and control. The President's contention that States and municipalities have been neglectful in meeting school needs really represents an indictment of the people in their votes on proposals to raise money for school building purposes. It is also an indictment of the Federal Government's own fiscal policies which have preempted so much of the money people are willing to pay in taxes that they naturally feel some reserve in voting still higher taxes.

Nevertheless, school building projects have been going forward at a rate and expense previously unknown. As Secretary of the Treasury Humphrey told the Senate Finance Committee on June 18, "a quarter of a million new school rooms have been built for our youngsters" in the

past four years. "Total public construction in 1956 was 23 per cent above 1952 levels, and educational construction up 56 per cent":

During 1956 alone, new borrowing by states and municipalities totaled $5.4 billion, and during the last 9 months for which figures are available, more elementary and secondary school bonds were sold than in any 9-month period in our history.

The Federal Government has no men and material stashed away ready to go to work building schools. Overburdened with debt, it has no money except what it can take away from the citizens of the 48 States. The main idea of the federal school-aid program is that "rich" States can be tapped to make up for school deficiencies in "poor" States. In other words, Massachusetts citizens can help build schools in North Carolina, New York can assist Texas, California can aid Kentucky, and Illinois and Ohio can support Georgia and Alabama.

Shifting Burdens

An interesting analysis of how the burden of school financing would be shifted was made last month by the U.S. Chamber of Commerce on the basis of the bill approved by the House Education and Labor Committee. This bill would provide federal construction funds for five years at the rate of $300 million annually. The Chamber's analysis of the bill was based on an estimate of each State's federal tax contribution towards the $300 million annual grants. These figures were compared with the allotments from the fund for each State.

As can be seen in the table, 17 States and the District of Columbia would pay more in taxes than they would receive in benefits. These States and the District would provide about $80 million annually to build classrooms in other areas, according to the Chamber.

It is a curiosity that the beneficiaries include so many areas that are advertising low tax burdens to attract industry and are developing faster than the nation as a whole. North Carolina, which would be the biggest beneficiary by the Chamber's calculation, took a full page in the June 20 *Wall Street Journal* to proclaim "North Carolina Reduces Taxes":

For 25 years North Carolina has maintained one of the most stable tax structures in the nation. It is closing the current fiscal year with a credit balance of $63,000,000. It has levied no new taxes, and has brought individual income taxes into line with many federal provisions.

This has been done without sacrificing State services. To the contrary, its educational system is being improved by increasing teachers' salaries 15% and salaries of other State employees by 11%. It is investing $40,000,000 in capital improvements at its institutions in the next two years.

This is no picture of "need" but of good local government dedicated to progress. But relieving North Carolina of educational costs at the expense, say, of New England textile centers is hardly cricket.

What may be still more of an eye-opener to many taxpayers of the "rich" States is the appearance of Texas in the guise of a "poor" State scheduled under the bill to receive federal handouts for school construction. However, Texas' Governor Price Daniel made it clear at Williamsburg that his great State wants no federal funds to build its schools.

How States Would Fare Under the School Construction Bill (H.R. 1 as Amended)

(In Millions of Dollars)

	Federal Allotment Receipts	Estimated Tax Payments	Net Receipts	Net Payments
Alabama	$8.9	$3.1	$5.8	$—
Arizona	2.2	1.4	.8	—
Arkansas	5.4	1.5	3.9	—
California	16.2	29.4	—	13.2
Colorado	2.8	2.7	.1	—
Connecticut	2.6	5.9	—	3.3
Delaware	.5	1.2	—	.7
Dist. of Columbia	1.8	3.8	—	2.0
Florida	5.7	5.4	.3	—
Georgia	9.8	4.0	5.8	—
Idaho	1.5	.7	.8	—
Illinois	12.3	22.4	—	10.1
Indiana	7.6	7.9	—	.3
Iowa	5.2	3.8	1.4	—
Kansas	3.4	3.2	.2	—
Kentucky	7.3	3.3	4.0	—
Louisiana	7.6	3.5	4.1	—
Maine	1.7	1.3	.4	—
Maryland	4.4	5.8	—	1.4
Massachusetts	7.0	10.1	—	3.1
Michigan	11.9	16.9	—	5.0
Minnesota	6.3	5.0	1.3	—
Mississippi	6.6	1.4	5.2	—
Missouri	5.5	7.5	—	2.0
Montana	1.3	1.1	.2	—
Nebraska	2.6	2.0	.6	—
Nevada	.3	.6	—	.3
New Hampshire	1.0	.9	.1	—
New Jersey	6.5	12.7	—	6.2
New Mexico	2.2	1.0	1.2	—
New York	18.7	38.0	—	19.3
North Carolina	11.8	4.3	7.5	—
North Dakota	1.6	.7	.9	—
Ohio	11.3	19.4	—	8.1
Oklahoma	5.1	3.0	2.1	—
Oregon	2.9	3.0	—	.1
Pennsylvania	18.1	20.9	—	2.8
Rhode Island	.9	1.6	—	.7
South Carolina	7.0	2.0	5.0	—
South Dakota	1.6	.7	.9	—
Tennessee	8.3	3.7	4.6	—
Texas	17.2	13.2	4.0	—
Utah	1.9	1.1	.8	—
Vermont	.9	.5	.4	—
Virginia	8.0	4.9	3.1	—
Washington	4.2	5.1	—	.9
West Virginia	5.5	2.3	3.2	—
Wisconsin	6.8	6.4	.4	—
Wyoming	.6	.5	.1	—
Alaska, Samoa, Guam, Puerto Rico, Hawaii, Virgin Is.	10.5	.1	10.4	—
Total	$300.0	$300.0	$79.5	$79.5

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